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No. 92-1751

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IN THE
# Supreme Court of the United States
OCTOBER TERM, 1992

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ALCAN ALUMINUM CORPORATION,
*Petitioner,*

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
*Respondent.*

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**On Petition for Writ of Certiorari to the Court of Appeal of the State of California In and For the Second Appellate District**

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## BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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AMY EISENSTADT *
Tax Counsel
JAMES F. BURESH
PAUL H. FRANKEL
Co-Chairs, Lawyer
Coordinating Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W., Suite 330
Washington, D.C. 20001
(202) 484-8103
* Counsel of Record

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### INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of the Court.

### INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association, which was organized in 1969 as an advisory committee on the Council of State Chambers of Commerce. COST, which was separately incorporated January 1, 1992, has a membership of more than 380 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve

and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Virtually all COST member companies are engaged in business in the State of California, either directly or through subsidiary operations, and are subject to that State's corporate income tax. COST member companies include a substantial number of organizations that are owned by non-U.S. corporations. A significant number of COST member companies are engaged in business in jurisdictions outside the United States and would be subject to retaliatory actions by such countries should worldwide combined reporting be upheld. Therefore, COST clearly has an interest in the instant case, in which the constitutionality of California's imposition of worldwide reporting on foreign parent unitary groups is at issue.[1]

## SUMMARY OF ARGUMENT

The State of California's imposition of worldwide combined reporting has been the subject of Foreign Commerce Clause challenges for over twenty years. Although this reporting method, as applied to domestic parent groups was upheld in *Container Corporation of America*

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[1] Under worldwide combined reporting, the method used by California to apportion the income of multinational corporations, the entire income of a worldwide unitary group is apportioned using a fraction which represents the ratio of in-state payroll, property and sales to worldwide payroll property and sales, to determine the income attributable to California. In contrast to the method employed by California, the United States and its international trading partners use the arm's length separate accounting method to allocate income of multinational corporations. Under this method, each corporate member of an affiliated group which comprises the multinational enterprise is a separate taxpayer. The affiliated members are treated as if they were unrelated separate entities for the purpose of determining income from intercompany transactions. The separate accounting theory eliminates the need for any formula division of income among different taxing jurisdictions because multinational income is allocated to each member corporation in accordance with its own transactions.

*v. Franchise Tax Board,* 463 U.S. 159 (1983), this Court explicitly reserved the specific question at issue in this case, that is, whether worldwide combined reporting as imposed on a foreign parent unitary group violates the Foreign Commerce Clause. 463 U.S. at 189, n.26.

Not only does this case raise the issue reserved by the Court in *Container,* it also presents certain facts that the Court emphasized as missing in *Container.* Unlike *Container,* the tax at issue in this case falls on a unitary group with a foreign parent. *Id.* at 195. Most importantly, this Court no longer has to guess at the risk of retaliation by foreign nations, 463 U.S. at 194, as the offense to our foreign trading partners has been clearly expressed by the United Kingdom's enactment of retaliatory legislation. Thus, ten years after *Container,* the Court is finally presented with a fully developed opportunity to answer the question left open in that case.

Because of the implications of the decision of the California Court of Appeal for the Federal Government's ability to conduct foreign policy; the importance of the issue to the states and to a large number of taxpayers, as well as foreign governments; and in consideration of the long period that this issue has been pending, this Court should grant the petitioner's petition for writ of certiorari.

## *ARGUMENT*

### CERTIORARI SHOULD BE GRANTED IN THIS CASE BECAUSE THE FEDERAL GOVERNMENT'S ABILITY TO FORMULATE FOREIGN TRADE POLICY IS IMPAIRED BY CALIFORNIA'S IMPOSITION OF WORLDWIDE COMBINED REPORTING ON FOREIGN PARENT UNITARY GROUPS.

Article I, § 8, cl. 3 of the United States Constitution reserves to Congress the power to regulate commerce with foreign nations and among the states. This Clause, "by its own force created an area of trade free from interference by the States" and "even without implementing legislation by Congress is a limitation upon the power of the States." *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 328 (1977). With regard to foreign commerce, the "constitutional prohibition against state taxation . . . is broader than the protection afforded to interstate commerce . . . because matters of concern to the entire Nation are implicated." *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* —— U.S. ——, 112 S. Ct. 2365, ——, 60 U.S.L.W. 4582, 4584 (1992). Because foreign commerce is afforded broader protection, this Court stated in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), that "[f]oreign commerce is preeminently a matter of national concern," 441 U.S. 448, and held that a state tax violates the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential." 441 U.S. at 448.

Three months ago in *Itel Containers International Corp. v. Huddleston,* 61 U.S.L.W. 4173 (Feb. 23, 1993), this Court reaffirmed that when a state tax is being scrutinized under the Foreign Commerce Clause, the tax must be analyzed under the tests set forth in *Japan Line,* as well as the four-prong test set forth in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).[2] Quoting

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[2] In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977), this Court set forth the following four-prong test for

*Japan Line, supra* at 451, this Court state in *Itel, supra* at 4176, that

> a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal government from "speaking with one voice when regulating commercial relations with foreign governments."

In *Container Corporation of America v. Francise Tax Board,* 463 U.S. 159 (1983), this Court elaborated on the "one voice" requirement of *Japan Line,* stating that where a state tax is at variance with federal policy, the "one voice" standard is violated if the state tax "*either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." 463 U.S. at 194 (emphasis in original). In determining whether the "one voice" test is violated due to the implication of foreign policy, this Court stated that "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.*

In *Container,* this Court felt that it could not determine when a foreign nation might be offended by a state tax policy. *Id.* However, one no longer has to speculate about whether foreign trading partners are so offended by worldwide combined reporting that retaliatory actions might be taken. In 1985, the United Kingdom enacted retaliatory legislation that would deny certain tax credits provided by the United States/United Kingdom Income Tax Treaty [3] to United States corporations doing business

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determining whether a state tax comports with the interstate commerce clause: 1) whether there is a substantial nexus between the state and the activity it seeks to tax; 2) whether the tax is fairly apportioned to the taxing state; 3) whether the tax discriminates against interstate commerce; and 4) whether the tax is fairly related to the services provided by the state.

[3] Under the United States/United Kingdom Income Tax Treaty, a United States corporation receives a refund of certain amounts of

in a state imposing worldwide combined reporting. Finance Act of 1985, Section 54, recodified as Section 812 of the Income and Corporation Taxes Act of 1988. Although the United Kingdom has not yet triggered this provision, as this Court recognized in Japan Line, "[t]he risk of retaliation . . . under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 450.[4] As this Court also stated in *Japan Line*, "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453.[5]

California's deviation from the internationally accepted allocation method also imposes enormous accounting and

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taxes withheld by a United Kingdom payor on dividends paid by that payor. United States corporations are entitled to this refund for taxes paid on dividends received from U.K. subsidiaries and from investments of at least 10% in unrelated U.K. corporations.

[4] In Unitary Tax: Review of Progress Towards Resolving the Problems, a Joint Report by Inland Revenue and the U.S. Treasury, issued in December, 1991, the United Kingdom reviewers concluded that, pending settlement of the issue of the constitutionality of worldwide combined reporting through litigation, the United Kingdom "should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it." ¶ 7.2.a.

[5] Any retaliatory action taken by the United Kingdom "of necessity would be felt by the Nation as a whole," *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 453 (1979), because the impact of its retaliatory statute is not limited to California based corporations. The United Kingdom may, at its discretion, consider a company to have a "qualifying presence" within California if it is subject to tax by the State or has a relatively small property, payroll or sales in California. Income and Corporations Taxes Act of 1988, Sections 812(1) and (3). Therefore, a corporation doing business in every state except California and receiving dividends from investments in U.K. corporations could face a greatly increased U.K. tax burden if it is simply affiliated with a corporation with minimal contacts with California.

administrative burdens on taxpayers with affiliates in both California and foreign countries. Since the foreign corporations that are required to be included in a worldwide unitary group are not taxable in the United States and may not have any transactions with any U.S. entity, they have no reason to maintain books and records on a U.S. basis or on a basis reflecting the State's three-factor (property, payroll and sales) formula. Thus, the use of the worldwide combined reporting system requires a totally separate record keeping system solely for California tax purposes.

The worldwide combined reporting method requires a foreign corporation to prepare and maintain records in United States currency. The required conversion of financial data of each foreign subsidiary to United States dollars must take into account many different exchange rates and sharp fluctuations of value. Such computations are a costly and burdensome administrative expense necessitated by California's deviation from international and federal tax standards. The costs of complying with the administrative requirements of California's tax system may, in fact, exceed any tax which is ultimately due the State.

The administrative compliance burden of worldwide combined reporting in the face of an otherwise uniform standard is prohibitive and creates the very barrier to international trade that the foreign commerce clause is intended to prevent. It also presents a formidable barrier to interstate commerce when a foreign-owned entity doing business in a non-worldwide combined reporting state, *e.g.*, Illinois, starts to do business in California. That entity, if related to any foreign entities through a foreign parent, would subject each company in the entire group to onerous record keeping requirements solely to satisfy California's tax return filing requirements. California is the only jurisdiction repudiating arm's length/separate ac-

counting by requiring all multistate and multinational corporation to use worldwide combined reporting.[6]

Taxpayers have challenged California's use of worldwide combination of Foreign Commerce Clause grounds since the State began enforcing this form of taxation. This Foreign Commerce issue is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that the Court must grant *certiorari* in this case.

## CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

AMY EISENSTADT *
Tax Counsel
JAMES F. BURESH
PAUL H. FRANKEL
Co-Chairs, Lawyer
Coordinating Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W., Suite 330
Washington, D.C. 20001
(202) 484-8103
* Counsel of Record

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[6] Taxpayers in California must pay a fee in order to file on a "water's edge" basis, thereby excluding foreign corporations from the unitary group.